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SUBJECT: AGRICULTURE REFORM IN JAPAN - TOO LITTLE TOO LATE FOR DOHA  
TALKS

First of a series

Summary  
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¶1. (SBU) Japan is set to change its policies in farm subsidies starting in fiscal 2007. Whether the changes will help the government to take a more accommodating posture in trade talks over the longer term -- both multilateral and bilateral -- remains to be seen, but nobody is predicting any dramatic shifts in course. The awkwardly titled "Legislation on Subsidies to Stabilize the Operations of Selected Farmers and Farming Institutions that Would Revitalize Japan's Farming Industry" involves more reliance on direct supports and is supposed to be more WTO-friendly. Passed in June, the legislation will likely prove too little too late. Japan will not be in a position to offer up substantial tariff cuts on agricultural commodities -- particularly on rice -- to resuscitate the Doha talks any time soon. If combined with other reforms, however, they could prove important in the future. End summary.

Ag Sector Now  
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¶2. (SBU) Japan is famously one of the most inefficient agriculture producers in the world, with an industry that remains a drag on the overall economy and the country's willingness to play a leadership role in the Doha talks. Some 85 percent of farmers are either part-time or producing for their own consumption. Excluding Hokkaido, average farm size is only 1.6 hectares. Japan's farmers are rapidly aging -- 70 percent are over 60 years old and 40 percent are over 70 years old. Their offspring are increasingly reluctant to continue the business on a full time basis because revenues from farming alone tend to be below the average income of the population. Those men who do stay on the farm sometimes need to look abroad for wives, as Japanese women are less and less interested in working a family farm. Overall, in part because of Japan's coddled farm sector, Japanese consumers are saddled with some of the highest food prices in the world.

¶3. (SBU) Owing to minimal cultivable land and irrational land use policies, the farm sector is distorted, with plots too small to make viable commercial enterprises. Farm owners are not selling their land in meaningful volumes; they prefer to hold properties in hope that the land will be rezoned for non-agricultural use -- for example, supermarkets, factories, and housing. Rezoning would boost potential land values and provide current holders with greater

incentive to sell off. However, laws recently passed to revitalize city centers will make such rezoning more difficult when they come into force in 2007. In addition, current policies -- including the recently passed agriculture reforms -- sidestep rezoning as a focus and instead seek to encourage consolidation by targeting farm subsidies on bigger farms.

¶4. (SBU) Japan's agriculture sector has been in a state of sclerosis for decades and land use policies are only part of the problem. Some reform-minded observers tell us that the recent changes, involving primarily the introduction of a targeted direct payment scheme, are inadequate. "Fake reforms" is how one agriculture expert at Meiji University kept describing the recent changes in a slide presentation for us in his office. The Diet passed the legislation after several months of being worked and reworked by the politicians and it will not go completely into effect until April 2007 at the start of Japan's next fiscal year. Farm sector supports will no longer be spread around to all farmers regardless of size, but be concentrated on farms of over four hectares -- or 10 hectares for farms in Hokkaido, Japan's relatively lightly populated northern-most island.

¶5. (SBU) Most observers -- including even some in the Agriculture Ministry (MAFF) -- agree that Japan cannot improve farm sector efficiency until farms are consolidated and much bigger than the targets in the current legislation. To get even the current reforms passed in the Diet, however, loopholes were introduced. Small farms that did not qualify for direct payments under the first draft of the legislation will be able to receive them if they form pseudo-cooperative arrangements with other small-scale farmers with total farming land of over 20 hectares. These farms, usually small in size and often with senior citizens tilling the land, will benefit not only from government handouts but also by pooling farming costs and encouraging more economies of scale.

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¶6. (SBU) In practice, observers note, the loophole could set farm consolidation back, although there is little data to make a case either way. Some incidents have been reported in which small farm holders, who today are willing to lease their properties to large-scale commercial agriculture concerns, will instead retain them and form the pseudo-cooperative arrangements in anticipation of government direct payments providing more income than the rents they currently charge the large commercial concerns. Adding to the distorting effects of the direct payments legislation, prefectures will have some say in who gets the handouts, making them a potential source of pork barrel largesse. According to the Meiji University expert we met, average farm size could remain very small -- close to the existing 1.6 hectares.

#### Outline of New Subsidies

¶7. (SBU) Putting aside what impact the new subsidies will have on consolidation, they target large-scale farmers that produce commodities such as rice, wheat, soybeans, sugar beets, and potatoes. One goal is that farmers will reduce rice production -- where a domestic production glut has contributed to a decline in prices -- in favor of other starches. Farms producing vegetables, fruits and livestock are not covered in the legislation. Currently, subsidies are specific to the commodity and are given to every farm that produces them, irrespective of land size. Even with the new loopholes in the legislation, the hope is that the new system will spur a Darwinian shakeout in the farm sector, with bigger producers buying out the least productive farmers. Eligible farms would also receive preferential rates on loans for their farming activities.

¶8. (SBU) As explained by MAFF, the new subsidy program has two elements, a base revenue insurance payment and a two-tiered payment based on past acreage plus those calculated on annual yields. The base revenue insurance payment would be funded three-fourths by the government and one-fourth by the farm and triggered when the farm's income for each commodity is below the average income for three out of the past five years, with figures for the lowest and highest years taken out. The payment would replace 90 percent of the total

loss, and is considered non-trade distorting under current WTO rules. The second payment is designed to remedy domestic production costs because they are higher than non-Japanese production costs. According to MAFF, the first tier of payments is calculated by past acreage and falls under the green box in WTO terminology. The second tier is based on annual yields and falls under the amber box.

¶9. (SBU) Defenders of the policy changes acknowledge that they are modest, although perhaps not in fiscal terms, where the MAFF budget for 2007 subsidies has increased slightly. Defenders argue, however, that the reforms will begin the process of much needed consolidation, and represent an interim step. Farmers will begin to run their farms more like businesses -- which in turn will underscore the need for more large-scale management. The reforms should also encourage diversification out of rice production. Farmers will be able to rotate their production throughout the year, leading to more revenue per square production unit. The incentive for this arises because rice producers will only be eligible for the base insurance payments, while those producing wheat, soybeans, sugar beets and potatoes will receive both elements of the subsidy program. How big the implications are is unclear; some farmers, especially for wheat and soybeans, will remain deterred by fierce import competition. And although rice farmers do not qualify for the two-tiered subsidies, an assortment of other subsidies -- such as handouts for farmers who practice environmentally friendly production techniques -- remains on the books.

¶10. (SBU) As part of the same package of reforms, MAFF is introducing measures that would lower central government control over production and enhance the influence of local decision makers on their agriculture policies. Take rice for an example: in the past, the government decided production volumes. Under the new system, the government will only offer information on estimated demand. Local farmers or farmers' cooperatives, with other community input -- including local officials, distributors, consumer interest groups, and academics -- will draft plans allocating production to producers who are willing to cooperate in planning output levels. The Ministry also has a set of subsidies available to the local farming communities for them to carry out agriculture

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reform at their own discretion -- one of the purposes would be for communities to shift production away from rice to other commodities.

Too Little Too Late?

¶11. (SBU) What effect will recent agriculture reforms have on the government's role in multilateral trade talks? There are different interpretations, but the basic answer is probably: not much. Even MAFF -- a bastion of conservative bureaucrats who view change with suspicion -- recognizes that for Japan to be competitive enough to begin to fend for itself without the prohibitive tariff walls that domestic farmers hide behind today, farms have to be much bigger than those called for in the new legislation. According to studies by Yoichi Tashiro at Yokohama National University, even if farmland were consolidated to 10 hectares, domestic rice would not be able to compete against foreign producers -- in other words, if tariffs were slashed to, say, 200 percent from the current 490 percent, never mind more ambitious targets, Japanese rice farmers would be devastated. MAFF's eventual target -- perhaps more accurately described as vague hope -- is to expand the size of family-owned rice paddies to between 15-25 hectares and corporate farms to 34-38 hectares.

Comment

¶12. (SBU) Looking at language contained in recently passed agricultural legislation, including the emphasis on consolidation and a move toward greater reliance on direct payments, there is room for a small modicum of optimism. Conservatives in Japan's agriculture lobby have at least felt the heat brought on by others in Japan who are more determined to open the economy up. Given the

harsh demographics of Japan's rural sector, even aging farmers -- and their heirs -- may eventually prove to be a force for more change. They want to see the reforms in rural land policy that will eventually translate into higher property values, where the land can be put to non-agricultural uses. They may ultimately prove unhappy with the current muddled efforts at land consolidation and ask for more genuine "liberalization" and not less.

¶13. (SBU) Only the most naive, however, should expect Japan to become ambitious in WTO agriculture talks anytime soon. The balance of political power today continues to rest in the hands of those that resist market opening. The independent, non-governmental Japan Economic Research Institute describes Japan's recent reforms as a "stepping-stone" for expanding scale and encouraging efficient farm management. The institute calls for additional measures to encourage further consolidation beyond the four hectares (10 hectares for Hokkaido) target and believes that reforms should cover vegetables, fruits and livestock, which have been excluded so far. But no major legislation is in the pipeline. Japan's most iconoclastic, reform-minded prime minister in the postwar period is leaving office. Optimists continue to point to the demographics of the agricultural sector, and to external events such as a possible FTA with Australia, or the model that a U.S.-Korea FTA might present, as spurs to substantial reform and market opening. The only thing certain is that Japanese agriculture will not be ready for the pressure of world competition anytime soon.